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AN ADVENTURE IN STATE INSURANCE

Humanity has perhaps done nothing better in the way of devising a purely human institution than in the field of insurance. By insurance we carry one another's burdens. Instead of waiting until after a catastrophe has happened and then taking up a contribution for the relief of those in distress, through insurance we take up the contribution in advance of the catastrophe and are therefore ready to relieve the distress almost immediately.

Workmen's compensation is insurance. It makes the employer the insurer of his employees; but he may hire some one else to carry that insurance in his stead if he so desires, through some mutual organization with other employers or through some insurance company organized as a corporation or through some state fund or bureau, as the circumstances may determine. The whole fabric of compensation to injured workmen is founded upon insurance principles and upon a just distribution of the risk among all persons liable under the risks of industry and in proportion to the hazards characteristic of each such industry.

California made its first essay into the compensation field of legislation in 1911, by the enactment of what was then commonly known as the Roseberry law, which was in fact the fourth tentative draft of the Wisconsin compensation law. State Senator Louis Roseberry whipped it into shape to fit California's nomenclature and political organization, and by that means put the Wisconsin law into effect in California a few months before it went into effect in Wisconsin.

The Roseberry law was crude and tentative only, elective in its terms, and sufficed mainly to enable the people of California to become familiar with the compensation idea as applied to industry and to make it possible for the then Industrial Accident Board to make such investigations and preparations as were necessary for the formulation of a more adequate and compulsory compensation law. There was otherwise ever so little for the Industrial Accident Board to do, during the two and a third years of life of the

Roseberry law, except to prepare and make ready for presentation to the legislature a draft for a workmen's compensation, insurance and safety act; and it was to this task that the Industrial Accident Board devoted the greater part of its time and energies.

During this interim the writer of this article made a careful and thoroughgoing study of the literature of all of the compensation insurance systems in the world; and, in order to acquaint himself with the insurance side of the insurance problem, he visited a number of eastern cities and held conferences with the managers of a number of large liability insurance concerns, and also met and conversed with those who, by reputation, were deemed best equipped to advise in relation to a just and workable plan for compensation insurance coverage for employers.

As a result of these investigations the writer became convinced that the existing facilities for insurance against the compensation risks of industry were inadequate and that, in justice, they should be made adequate before imposing upon the industries of California a compulsory compensation law; and yet no other form of law than a compulsory one could adequately protect the working people of California from the pauperizing consequences of industrial injury. The great insurance companies were prone to get together and stand together on premium rates, if on nothing else, and adventurers were disposed to organize wildcat, fly-by-night, cut-rate concerns, mainly for the stock-jobbing profits to be made out of the organization rather than for the earnings to be derived from legitimate insurance, all of which worked to the detriment of employers and their injured employees.

It was in the insurance literature of New Zealand that there was first found an idea which seemed to be capable of being whipped into practical form for meeting the requirements of insurance under a compulsory compensation insurance act. Having opened correspondence with the proper officials in New Zealand, we were soon well stocked with reports in relation to the workings of their system of state insurance in free competition with about twenty-five other insurance carriers of one form or another in the compensation field. We found that, in New Zealand, while the state insurance fund was doing only about 10 per cent of the insuring against compensation risks, and was doing that in free and fair competition, the effect of the state's competition upon other insurance carriers was to secure fair premium rates for the employer and fair treatment for the employer's injured employees,

and these were the ends we were seeking in California. We borrowed the idea from New Zealand, but we dressed it in garments better suited to the industrial and political situation in California and presented the measure to the legislature of 1913.

The new bill was entitled "The workmen's compensation, insurance and safety act," and it was warmly espoused by the then governor, Hiram W. Johnson, now United States senator; and, with his hearty coöperation and by reason of the progressive trend of legislation in California at that time, the Industrial Accident Board was able to induce the legislature to empower it, as a commission, to establish a state compensation insurance fund in what was ultimately to be free and fair competition with other insurance carriers and to place to its credit in the state treasury $100,000 as cash capital to begin business on. This was the foundation upon which the superstructure of a compensation and safety act was based.

It was what Governor Johnson regarded as a "bully fight." The corridors of the capitol building swarmed with insurance men, all with their knives whetted to a keen edge and with bloody-minded intent upon killing the bill if they could consummate its death, but at all events to do it great bodily harm. They did neither. They were beaten at every point and were able to make almost no change at all in the text of the measure as submitted to the legislature by the then Industrial Accident Board. The bill passed both houses with large majorities, was signed by the governor, and went into effect January 1, 1914.

An idea incorporated in the fund was to create a model insurance carrier which other insurance carriers in competition with it would, by the logic of circumstances, be required closely to approximate on pain of having the business go to the state fund; and it required about four months of experience under the new act to enable them to appreciate the force of the argument. It was intended also that the policy of the fund should be influenced by the moralities involved in each situation rather than by the legalities alone; that is, it was purposed to make the fund a warm-blooded financial institution rather than a cold-blooded one; and this policy has been consistently pursued ever since. It was also determined that as soon as the fund became strong enough its competition with private insurance carriers should become wholly fair; it should pay the same taxes that other insurance carriers were required to pay, and it should derive no direct advantage

from the state's other activities not shareable by all other insurance carriers in competition with it in the compensation field.

The following were the chief arguments advanced against the adoption of the measure by the legislature:

1. That the insurance field belonged to private enterprise.

The proponents of the measure dissented from this proposition and held insurance to be a public service, a service which the state could directly perform, in whole or in part, to the exclusion of all other carriers or in competition with them, for the reason that the public welfare, which the state was created to protect, was vitally involved in the institution of compensation insurance, at least. It was held that the state might delegate such a service to a private or mutual enterprise or might discharge the obligation itself; that the issue was not academic, but practical, and that the decision should depend upon which plan is likely to work the better. It was then, and still is, the judgment of the writer of this article that the competitive plan would work best for employers, best for employees, and the best for the economic interests of the state, as well as best for the state fund, which needs competition to keep it progressive in its efforts to render the best possible service at a reasonable cost for the performance of such service.

2. It was contended that politics must inevitably get into the management of the fund, and so hopelessly injure it.

It cannot be denied that there was, and always has been, some danger of such an eventuality, but for more than five years not one appointment to a position within the State Compensation Insurance Fund has been made through political consideration. The fund has not only kept out of politics, but it has kept politics out of the fund, which has been to the very great advantage of the fund as well as of the politics of the state.

Furthermore, all of the employees of the fund, except the manager and the heads of departments, are employed through a vigorous and rigorous state civil service law, which is entirely nonpartisan in its operation.

3. That the state fund would get the bad risks and the insurance companies the good ones.

That there is such a tendency wherever the state enters the insurance field in competition with other insurance carriers is true enough, but the state fund in California has resisted this tendency and has put forth its energies to aid the bad risks in becoming

good risks before they are given insurance coverage, and with a high degree of success. The fact that the loss ratio of the fund is lower than that of the average for other insurance carriers shows that it has selected its risks with as high a degree of underwriting judgment as other insurance carriers and that it has not had more than its just quota of bad risks to carry.

4. It was dogmatically declared that private enterprise can do business cheaper than the state.

The writer is inclined to agree with the proposition that private enterprise *can* do business more cheaply than the state, but that it will not do it as cheaply as the state if it can avoid it.

The insurance carriers in competition with the fund have stoutly claimed that they cannot do the business of insurance with an overhead expense of less than 35 per cent of the premiums received; and, during the last year and a half, they have so raised their rates as to allow 40 per cent for this purpose. The cost of the state fund's doing business has only once exceeded 15 per cent and for the year 1918 it was a trifle less than 12 per cent, or, to be exact, 11.79 per cent of the net premiums received. In other words, the state fund is transacting business at one third the cost which the private insurance carriers set aside for that purpose. Yet the only part of the expense of the fund which the state bears is that the state pays the salaries of the industrial accident commissioners, who sit as a board of directors for directing the general policy of the fund, and to this task the commission does not devote more than two hours per week. That is absolutely all the benefit or advantage the state fund gets by reason of state aid, and that is negligible. The fund now pays the same taxes that other insurance carriers pay, pays for all its own labor and rent and every other element of cost in doing an insurance business; but it does the business economically, wines and dines no legislators, and does not seek to hire employers to give it their business through any form of hospitality or entertainment. The writer has all along felt that if private insurance carriers would have a good housecleaning and a reorganization of their methods of doing business they could stay in the field in competition with the state fund and make a fair rate of profit on their investment.

The fund must invest the money in its control as savings banks invest their funds; the private insurance carriers may invest "other people's money" in their possession as commercial banks invest, or as promoters, for that matter, and so make a larger

return than the fund can upon its investments. Private insurance carriers may hire their labor in the open labor market and may work their employees as many hours as they can induce them to work. The fund must secure its labor from the State Civil Service Commission and pay salaries comparable to those paid in other departments of the state service.

5. It was contended that it is unjust that three commissioners, whose duty it is to sit in judgment over controversies between injured persons and insurance carriers, should also sit as a board of directors in the operation of an insurance concern in competition with such other private insurance carriers.

The commission has always admitted that there is just here an academic inconsistency in the act, but there was no good way of avoiding the difficulty. If the industrial accident commissioners were minded to be unjust and to discriminate against private insurance carriers and in favor of a state fund they could do this just as readily without regard to whether the commission controlled the fund or whether its control were placed wherever else it might be placed—in the hands of a separate commission, the state insurance commissioner or the manager of the fund alone—and yet the opportunities so to discriminate would be very few. All of the decisions of the commission are open, and discriminations could not be practiced without being called to public attention, a deserved condemnation being visited upon the heads of the commissioners. In default of proof of such discrimination—and no such proof has ever been forthcoming in spite of frequent challenges to produce it—the issue becomes what Abraham Lincoln properly characterized as "a pernicious abstraction." Our manager of the fund is so fully persuaded that there is no discrimination against other insurance carriers and in favor of the fund that he feels that the commission leans over backward, and perhaps it does.

The commissioners do consciously discriminate in many instances, but always against the fund. This is done where the legalities would require the denial of compensation if the insurance carrier were a stock company, insistent that it should be required to pay only what the law required it to pay, but where the commissioners believe that the moralities require the payments to be made. As long as government by law stands there will probably be a broad difference between justice as measured by the legalities and as measured by the moralities. Legalities must deal with common conditions and can seldom adjust themselves to spe-

cific cases. The moralities may deal with specific cases which do not fall into line with the law of average, and all insurance is based upon the law of average. The commission does this with good conscience, feeling that if by so doing the employer is taxed a little more for his premiums the burden is offset many times over by economies practiced by the management in the conduct of the fund. In short, as hereinbefore suggested, the difference between the policy of the fund and that of many stock companies consists in this: that the fund is made a warm-blooded financial institution, whereas those who are in the insurance field for the profit they can make out of it tend to make their concerns cold-blooded financial institutions; and in the practical operation of these different tendencies differing results of considerable importance to humanity are attained. Furthermore, no board or commission not in daily contact with the administration of a compensation law can know how to make an insurance carrier respond to the requirements of such a law.

The State Compensation Insurance Fund of California was ready for business on January 1, 1914, and it was gotten ready by the then Industrial Accident Board, operating under the Roseberry law, and by the expenditure of something less than $5,000 in equipping a business office and employing a manager and a few assistants for about two months so that the fund might be ready when the new compensation, insurance and safety act went into effect. This expenditure covers absolutely the only cost that the fund has occasioned the state except the use of the $100,000 capital provided by the act of the legislature of 1913.

The first prerequisite was to devise premium rates to be charged employers under the new act, but it was not within the scope of human knowledge to know in advance what the premium rates should be for the ensuing year. A basis of information and experience did not exist. Accordingly, the fund adopted the rates charged by the liability insurance companies, based upon such experience in this and other countries as could be made available, making sure to collect enough in premiums to cover the payments necessary to be made; and the fund has ever since charged the same rates that other insurance carriers have charged, these being the minimum rates fixed by the state insurance commissioner, except that the other carriers, at the beginning of 1918, increased their rates 5 per cent, which increase the fund did not meet. It will probably be ten years before a volume of experience in rates

can be accumulated that will justify making premium rates anything more than tentative, but any good bookkeeper can tell at the end of the year what the rates should have been. For this reason it has been the policy of the fund to make its policies "participating," as insurance men call them; that is, at the end of each year, the policy holders participate in any savings that have been effected in the course of the year's business in the form of dividends; and "dividends," in insurance, mean that the insurer has paid that much too much for his insurance. At the end of each year the state fund has returned 15 per cent of the premiums received to the policy holders on an average, some more, some less, as the experience in each classification warranted.

The legislature of 1915 enacted a reserve law requiring insurance companies to retain, undistributed to their stockholders, a certain percentage of their premiums intact for three years before releasing them to their surplus accounts. Upon the expiration of this term the fund returned to its policy holders of 1914, 20 per cent additional dividends, besides the 15 per cent returned at the end of that year, making 35 per cent in all on the premiums paid during that year. The next year there was paid a second dividend to the policy holders of 1915 of 18 per cent, making 33 per cent of the premiums paid during that year; and it is anticipated that the fund will go right on making its regular 15 per cent return, if not more, at the end of each year, and, three and a half years after, a second dividend of 15 to 25 per cent, owing to what the loss experience and the cost experience have been. Now that, as will be seen further on, the capitalization of the fund has been made adequate, the dividends repaid to policy holders should be greatly increased unless restricted by an exceptionally unfavorable loss experience. It is almost needless to say that the competing insurance carriers have made no such returns. In this way those who insure with the state fund get their insurance at exactly what it does cost the state to do the insuring, no more and no less. More than this they have no right to demand and less than this they have no obligation to put up with. The dividends so repaid by the fund during the first five years of its existence aggregated $790,000.

It may be of interest to note the growth of the business of the fund year by year. For 1914, the premiums received amounted in the aggregate to $547,161.24; for 1915, $655,676,55; for 1916, $928,281.15; for 1917, $1,373,791.54; for 1918, $2,459,086.08. The prospects are that the premium receipts of

the fund for the current year, 1919, will equal or exceed three millions.

The overhead cost of doing business for the year 1914 was 12.65 per cent; for the year 1915, it was 15.48 per cent; for 1916, 14.05 per cent; for 1917, 14.76 per cent; for 1918, 11.79 per cent; or an average of 13.75 per cent for the five years of the existence of the fund.

It was declared in the act that: "said Fund shall, after a reasonable time during which it may establish a business, be fairly competitive with other insurance carriers and it is the intent of the Legislature that said Fund shall ultimately become neither more nor less than self-supporting." The time has come when this ultimate ideal is realizable. The $100,000 capital with which the fund was supplied by the state was inadequate to enable the fund to carry the largest risks offered it or to be certain of not being wholly wiped out by some catastrophe hazard. Therefore, if the fund was to perform the service reasonably required of it by the state it was necessary for it largely to augment its capital and surplus. In short, it needed a round million dollars as an anchor to windward to justify full faith and credit in its ability to pay all losses and to carry the largest risks the employers of the state had to offer. It was useless to appeal to the legislature for any such sum of money and the only other way to obtain it was to keep back from the policy holders a share of the excess premiums paid and interest earned. This was done and yet, in spite of returning the $790,000 to policy holders above referred to, and in spite of the active competition of many other insurance carriers, the State Insurance Fund of California has accumulated a surplus so rapidly that the commissioners are almost ashamed to let policy holders know how profitable the enterprise has been as a money-making institution.

On the 31st day of December, the fund had a net surplus, not including the $100,000 capital given it by the state, amounting to $1,038,958.96, without a dollar of indebtedness chargeable against it; and this accumulation has been made in five years, charging the same rates or lower rates than other insurance carriers charged and, for a portion of the time at least, bearing all of the tax burdens that other insurance carriers had to bear. Meanwhile, the $100,000 original capital has never been touched, except that it was placed at about 4½ per cent interest. The average profit per year was $207,791.79, and the ratio of the average profit to the capital was, in round numbers, 207 per cent per annum, notwith-

standing the return of $790,000 to the policy holders above referred to.

If no dividends had been declared or paid to the policy holders the accumulated surplus would then have been $1,690,191.54, the average annual profit for the five-year period would have been $338,038.51, and the ratio of profit to the capital invested would have been 338 per cent per annum. It should be noted just here that whatever the other insurance carriers did with their surplus they did not return any of it to the policy holders and it is not believed that many of them have much of it to their credit at this time.

Again, assuming that the state fund had been started as a stock insurance corporation, and that the stock had paid regular annual dividends of 6 per cent and so remained at par, the 6 per cent dividend to stockholders would have taken $30,000 from the heretofore mentioned surplus and accumulation; but, deducting this and proposing to make a stock dividend to the shareholders for the distribution of the accumulation, the shares would then have had a market value of $1,108, instead of a par value of $100. In the expressive language of financiering circles, this would be known as "cutting a melon," and no doubt the melon would have been relished by the shareholders; but, assuming that the fund, conducted as a stock company, had returned no dividends to policy holders other than the 6 per cent above suggested, the other conditions of the business remaining the same, a much larger and more juicy melon could have been served up to the stockholders, for the shares would then have been worth $1,760, instead of $100 par value. This looks like making money pretty fast.

While the State Compensation Insurance Fund has been prospering as above made evident, five of its competitors in the field have failed and gone into liquidation, leaving small assets to their stockholders and leaving hundreds of injured employees and their dependents uncompensated; and ten other insurance companies have retired from the compensation field unable to do a profitable business in competition with the state fund. There are still about twenty insurance carriers in the field, but most of them complain that they are unable to make any money out of insuring against compensation risks.

However, the state is doing only about 40 per cent of the insuring of compensation and 60 per cent of it still goes to other carriers, mainly to stock companies. Just why so many employers persist in giving their business to the stock companies in the face

of the well known fact that the state fund ultimately returns at least one third of the premiums to the insurers is not entirely clear. The stock companies attribute their success in getting business, notwithstanding this handicap, altogether to salesmanship, but it would seem that salesmen who can sell insurance for a third more than it can be had for elsewhere are wasting their time selling insurance, which at best does cost a great deal of money, when, as in California, there is so much blue sky to be sold that does not cost anything at all.

The black beast which pursues the insurance carriers is the insurance broker. He performs a useful service, but is paid by the wrong party. If an employer desires to have a broker place his insurance for him it is proper for the employer to hire such broker to render him that service and pay for it, just as he would pay for the services of an attorney; but, under a system which has grown up in the insurance field, the insurance carrier pays the broker, and the broker, having secured a client, hawks the business from company to company and places it where he can do best for himself—and he does this with old business as well as with new. Therefore, every insurance carrier must fight to hold its old business as tenaciously as it fights to get new business. This is a very great source of expense to insurance carriers and they have not the courage to shake off the incubus, whereas the state fund, at the outset, declared that it would pay no brokerage, and so its acquisition cost is only a fraction of that of its competitors in the insurance field. If the other insurance carriers do not cut themselves loose from this drag upon their resources it will only be a question of time when the stock companies will have to retire from the compensation field of insurance and the fund will have a monopoly of that field by operation of the natural laws of trade, rather than by compulsory legislation. The remedy is easy to suggest and not very difficult to apply. It would consist merely in a gentlemen's agreement to pay no more commissions for anything except new business and to let one another's existing business severely alone. If this were done, and lived up to, it would save a very important source of overhead cost to the private insurance carriers and would probably enable them to stay in the field in wholesome competition with the state fund. The only reason apparent why this has not been done is that the insurance gentlemen in charge of the insurance companies know each other too well.

It cannot be questioned that the State Compensation Insurance Fund of California has proven a marked success. It has furnished insurance coverage to its patrons for one third less than it has cost those employers who placed their insurance with private insurance companies and yet it has been more liberal than the private companies in its treatment of injured employees. At the same time it has made money hand over fist. Its surplus is invested in municipal, state, and liberty bonds and its underwriting has been prudent and based upon sound insurance principles.

The members of the Industrial Accident Commission of California would not think of taking to themselves any great share of the credit for the result attained. By far the larger share of this credit goes to Mr. C. W. Fellows, the manager of the state fund, and the staff of lieutenants he has gathered about him. However, this adventure in state insurance does not prove that all forms of state insurance are preferable to insurance by private enterprise. There have been state funds that were mismanaged, just as there have been private insurance companies that were mismanaged, and there have been other state funds that were not founded upon sound principles of insuring, and of course bad management and unsound principles can only work for failure, not success.

At the beginning the writer spoke of the beneficence of insurance. Now, in conclusion, he desires to emphasize the fact that the possibilities of insurance for the relief of human hardship have been only partly utilized. The hazards of life, such as sickness, unemployment, industrial injury, premature death, can be guarded against only through insurance. There is no other way under a free society and there are those now living who will live to see the time when the states of this Union, in common with California, will have to make choice between a comprehensive system of social insurance that will insure against the hazards of life from the cradle to the grave or accept socialism or social anarchy in its stead. All these forms of insurance are essentially within the scope of social obligation and we in California think that our "adventure in state insurance" furnishes at least a reasonable hope that if the state shall be called upon to furnish insurance against the other hazards of life at what such insurance is reasonably worth, as well as against those of industrial injury, the state can assume the obligation with confidence in its ability to discharge it.

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